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DCI Talking Points

1. Iraqi and Iranian air attacks against oil tankers in the Persian Gulf have raised the cost of oil shipments from the Gulf, and stimulated a small increase in spot oil prices. The market has reacted to:

-- The increasingly regular pattern of Iraqi attacks against tankers calling at Kharg Island--about one attack every five to six days.

-- Four Iranian attacks against tankers bound to or from Kuwait.

2. Iraqi statements indicate an intention to press the campaign against Iranian oil exports as hard as military capabilities allow. These capabilities are increasing. The Iraqis evidently hope to pressure the great powers into forcing an end to the war or at least to take stronger measures against Iran.

3. The Iranian government has announced a policy of retaliation against Southern Gulf oil shipments or facilities and so far has responded to Iraqi attacks on a tit-for-tat basis. What actions Iran will take in the future will depend at least partly on the degree of success of Iraq's air campaign on Iranian oil exports. Iranian oil exports have been cut by over 50%, but this may be temporary. If such a cut can be sustained, or a deeper cut achieved, Iran will probably escalate its military response.

4. Major Iranian military escalation could take several forms:

o Launching a full-scale assault against Iraq, probably on the Basra front.

o Expanding air attacks against tankers to include those serving Saudi Arabia.

o Air or sea attacks against key Kuwaiti or Saudi oil and desalination facilities.

o Terrorist attacks or sabotage against these facilities, or attacks on Saudi and foreign personnel.

o Trying to close the Straits of Hormuz.

5. Iraq is probably not yet capable of largely closing down Iranian oil exports through attacks on tankers. With only five Super Etendard aircraft capable of attacking ships well beyond Kharg Island and carrying EXOCET missiles, Iraq probably cannot launch attacks more than once every five or six days without risking unacceptable aircraft losses. Attacks of this frequency and a tit-for-tat Iranian response would cause some disruptions, but no major impact in world oil markets.

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-- Insurance rates to Southern Gulf ports would increase further and some companies would pull out, but there would be only a moderate reduction in oil shipments.

-- The market is reacting not only to the number of attacks and the number of tankers hit, but also to the amount of damage. So far, 10 or so tankers have been hit by Iraqi and Iranian actions. Only one was sunk; damage was, on the whole, readily repairable. Damage of this magnitude is clearly an insurable risk and not nearly sufficient to halt the flow of oil.

-- There is more than enough excess capacity outside the Gulf to compensate for moderate reductions in Persian Gulf shipments and a willingness to use this capacity to make up for these losses.

6. The situation may change dramatically in late summer, when acquisition of Mirage F-1 aircraft will greatly increase Iraqi capabilities against tankers. By late August, Iraq should be able to attack at a rate of a tanker a day on the average. This could virtually stop shipments from Kharg and the Iranians would probably launch attacks against all Gulf tanker shipping, or try to close the Straits of Hormuz or attack Saudi oil facilities. Instead of just raising the cost of shipping from that area, the attacks would make Gulf oil shipments uninsurable. And none of the large companies would be willing to risk the voyage without insurance.

7. A major crisis over Gulf oil could come much sooner than late summer, however, if Iraq can make good its threat to seriously damage Kharg Island.

-- Iraq has the capability to do considerable damage to Kharg, using aircraft and the inaccurate but large SCUD missiles.

-- Some lucky hits on critical facilities at Kharg would be required, however, to greatly curtail oil export capacity, and recent exports require only a fraction of Kharg's capacity.

-- The Iranians probably would react strongly.

8. Given the announced Iraqi policy of stopping the flow of Iranian oil, the fact that the Iraqis are using all their current capabilities to that end, the projected increase in Iraqi military capabilities and the pattern of Iranian reaction, the risks are very high that we will face a severe crisis late this summer or sooner, if Iraq cannot be dissuaded from continuing on its present course.